

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of)  
)  
PRINCEVILLE UTILITIES COMPANY, INC.)  
and PRINCEVILLE PUC, LLC )  
)  
For Approval of the Transfer of )  
Ownership and Control, and Related )  
Matters. )  
\_\_\_\_\_)

DOCKET NO. 04-0292

DECISION AND ORDER NO. 21564

RECEIVED  
2005 JAN 31 A 8:12  
DIV. OF CONSUMER ADVOCACY  
DEPT. OF COMMERCE AND  
CONSUMER AFFAIRS  
STATE OF HAWAII

Filed Jan. 27, 2005  
At 11 o'clock A.M.

Karen Higashi  
Chief Clerk of the Commission

ATTEST: A True Copy  
KAREN HIGASHI  
Chief Clerk, Public Utilities  
Commission, State of Hawaii.

K. Higashi

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Docket No. 04-0292

Decision and Order No. **21564**

DECISION AND ORDER

I.

Background

By this decision and order, the commission grants PRINCEVILLE UTILITIES COMPANY, INC. ("PUCI") and PRINCEVILLE PUC, LLC's ("Buyer") (collectively, "Applicants") joint request for commission's approval: (1) to transfer ownership and control of PUCI; and (2) of certain transactions associated with the change of ownership and control.<sup>1</sup> Applicants make their requests pursuant to Hawaii Revised Statutes ("HRS") §§ 269-17, 269-17.5, and 269-19.

Applicants served copies of their Joint Application upon the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"). On November 1, 2004, Applicants responded to the Consumer Advocate's information

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<sup>1</sup>Joint Application, Verifications, Exhibits 1 - 7, and Certificate of Service (collectively, the "Joint Application").

requests. The Consumer Advocate does not object to the commission's approval of the Joint Application.<sup>2</sup>

## II.

### The Entities

PUCI, a Hawaii corporation, holds a certificate of public convenience and necessity to provide water and wastewater utility services within the Princeville resort and community service area on the island of Kauai.<sup>3</sup> Princeville Corporation ("Seller"), a corporation privately held by three (3) firms organized under the laws of Japan, owns all of the issued and outstanding shares of PUCI's capital stock.

Buyer is a newly formed Delaware limited liability company that is qualified to conduct business in the State of Hawaii. Buyer's sole member is Princeville Associates, LLC ("Princeville"), a Delaware limited liability company. Princeville's members are: (1) Hawaii Land Development Corporation ("HLDC"), a Hawaii corporation; and (2) Morgan Stanley Real Estate Funds ("MSREF"), a series of real estate investment funds sponsored by Morgan Stanley.

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<sup>2</sup>Consumer Advocate's Statement of Position, filed on November 16, 2004.

<sup>3</sup>See Decision and Order No. 9773, filed on May 27, 1988, in Docket No. 6137. Applicants note that pursuant to an agreement with the County of Kauai, Department of Water ("KCDOW"), "PUCI [also] provides water to a KCDOW distribution system serving a small number of residents in Anini Beach and along the back road into the old Hanalei Plantation." Joint Application at 3, footnote 1.

### III.

#### The Four (4)-Step Transaction

The transfer of ownership and control of PUCI ultimately involves a four (4)-step process.

#### A.

##### Sale and Transfer of Stock

Princeville is acquiring all of Seller's assets, including all of PUCI's issued and outstanding shares. Said shares, in turn, will be transferred to Buyer, pursuant to a Stock Sale Agreement, dated September 9, 2004 (the "Sales Agreement"). The purchase price of PUCI's capital stock is \$1.8 million, an amount that approximates the value of PUCI's depreciated rate base as of June 30, 2004.

Applicants note that, upon closing, Buyer, a Delaware limited liability company, will hold all of PUCI's outstanding capital stock. Hence, Applicants request the commission's approval of the sale and transfer of all of PUCI's issued and outstanding shares to Buyer, pursuant to HRS § 269-17.5.

#### B.

##### Conversion of Debt to Equity

PUCI currently has approximately \$2,637,349 in advances and other loans payable to Seller recorded on its books. Immediately prior to the closing of the transaction, Seller will convert the existing debt to equity as additional paid-in capital, pursuant to the Sales Agreement.

C.

Purchase of New Water Assets

At closing, PUCI will also purchase from Seller:

(1) a newly completed water well, identified as Water Well No. 4;

(2) a new 500,000 gallon water reservoir/tank; and (3) all associated water lines and other facilities constructed by Seller (collectively, the "New Water Facilities"). The purchase price is approximately \$3,565,000, which is equal to Seller's actual cost, including capitalized interest, reduced by crediting the amount of contributions-in-aid-of-construction ("CIAC") previously paid for by third-party developers.<sup>4</sup>

Applicants represent that, upon PUCI's acquisition, the New Water Facilities will: (1) be used and useful for utility operations; and (2) assist PUCI in meeting current and near term demand water utility services.

D.

Financing the Purchase of the New Water Facilities

Princeville will loan PUCI up to \$4 million, with interest at 8.5 per cent amortized over ten (10) years, to purchase the New Water Facilities, pursuant to a loan commitment,

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<sup>4</sup>Applicants initially identified the purchase price as \$3 million, see Joint Application at 5, paragraph number 3, but later corrected this amount to \$3,565,000. See Applicants' response to CA-IR-2(a).

dated September 28, 2004.<sup>5</sup> PUCI must pledge the income stream from its operations to secure the repayment of the loan.

With respect to the loan balance (approximately \$435,000) in excess of the purchase price, Applicants represent that Princeville and Buyer "are both desirous that PUCI be sufficiently capitalized with the ability to finance planned capital expenditures, as well as any unforeseen capital expenditures. Funds beyond the approximately \$3,565,000 will not be drawn down unless and until those additional funds are needed."<sup>6</sup>

Applicants request the commission's approval to: (1) enter into the financing arrangement with Princeville, related to the acquisition of the New Water Facilities, pursuant to HRS § 269-17; and (2) encumber the utility's income stream, pursuant to HRS § 269-19.

#### IV.

##### Applicants' Position

In support of their requests, Applicants state:

1. PUCI will continue to be a fit, willing, and able provider of water and wastewater utility services, and will abide by and conform to all applicable commission orders, rules, and other requirements. Upon closing, PUCI will be financially stronger and better able to fulfill its public utility

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<sup>5</sup>Although the loan commitment by Princeville is in writing, see Exhibit 4 of the Joint Application, it appears that the loan agreement is not yet executed. See id. at 2, paragraph number 2, and 4, paragraph number 4.

<sup>6</sup>Applicants' response to CA-IR-3(a).

obligations. For example: (A) much of the debt service currently on PUCI's books will be eliminated; and (B) PUCI will have a firm capital commitment necessary to undertake capital improvements and to expand its services, service area, or both.

2. PUCI's last rate increase was in 1997. In general, PUCI's stand-alone financial condition has been stable over the years, with its annual revenues virtually constant between 1997 and 2003.

3. Princeville, the new owner of the Princeville development, will indirectly own PUCI through Buyer, a separate, single-purpose entity. Because of this affiliation, "incremental growth in demand for utility services within the Princeville resort community can and will be closely coordinated with the expansion of the utility plant. This coordinated approach benefits the community, the utility and its customers, the residents, businesses and visitors to the Princeville resort."<sup>7</sup>

4. PUCI's staff provides its operations with a full complement of personnel that are highly experienced in the water and wastewater industries. In addition, upon closing: (A) PUCI's staff have expressed an interest in continuing their employment with PUCI under the new ownership; (B) the same Manager that has managed PUCI's operations for the past seven (7) years will continue to manage PUCI; and (C) PUCI will continue to rely on outside consultants for studies, technical plans, and professional services, whenever required.

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<sup>7</sup>Joint Application at 8.

5. The transfer of ownership will be transparent and cause no disruptions in utility services, meter readings, billings, or other administrative aspects of PUCI's utility operations.

6. The transfer of ownership "will not, in of itself, affect existing rates. Those rates, most recently approved by the Commission in 1997, remain in effect after financial closing."<sup>8</sup>

7. Consistent with the commission's past rulings: (A) neither Buyer nor PUCI will seek to directly or indirectly recover from PUCI's ratepayers any acquisition premium costs, goodwill impairment charges, or amortization of goodwill, notwithstanding any generally accepted accounting principles to the contrary; and (B) PUCI will not seek to recover any transaction or transition costs or amortization of such costs through rates charged to PUCI's ratepayers.

For these reasons, Applicants assert that the overall transaction is reasonable and consistent with the public interest.

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<sup>8</sup>Id. at 9. Concomitantly, Applicants state that, "[w]hile the transaction will not affect existing rates, PUCI reserves the right to seek rate increases in the future to account for changes in patterns of usage, increased operating expenses, and expansion of facilities." Id. at footnote 8.



V.

Consumer Advocate's Position

A.

Sale and Transfer of Stock

In evaluating the sale and transfer of PUCI's share, the Consumer Advocate examined: (1) Applicants' technical, financial, and managerial abilities; (2) Applicants' fitness and willingness to provide the utility services; and (3) whether the sale and transfer of stock is or will be consistent with the public interest.

The Consumer Advocate finds that:

1. PUCI will continue to possess the technical expertise to provide the utility services under the new ownership.

2. Buyer "will be able to secure the necessary water well facilities needed to sustain PUCI's ability to provide the utility potable water service and meet the needs of its customers in the future."<sup>9</sup>

3. Based on its review of PUCI's annual report and the financial information attached to the Joint Application and responses to the Consumer Advocate's information requests, Buyer "appears to have financial resources at its disposal from its affiliate members HLDC and MSREF."<sup>10</sup>

In addition: (A) Seller agrees to convert existing debt to equity as additional paid-in capital, prior to closing,

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<sup>9</sup>Consumer Advocate's Statement of Position at 4.

<sup>10</sup>Id. at 5.

thereby: (i) reducing the amount of PUCI's liabilities; and (ii) significantly improving the financial condition of PUCI's balance sheet; and (B) PUCI's projected five (5)-year statement for the 2004 to 2009 period "reflect sufficient funds to cover operating expenses, capital expenditures, and financing payments throughout the period with the inclusion of an assumed rate increase of approximately 30% in 2007."<sup>11</sup>

These findings support "Applicants' financial abilities to effectively continue to provide potable water and wastewater service after the sale of stock and change of control."<sup>12</sup>

4. Applicants' willingness to provide the utility services is evident by Buyer's willingness to: (A) utilize its financial resources to improve PUCI's financial condition; (B) loan PUCI up to \$4 million to purchase the New Water Facilities; and (C) have Princeville, the new developer of the Princeville resort community, coordinate its plans for developmental growth with PUCI in order to better prepare the utility's expansion plans.

5. The sale and transfer of PUCI's stock is consistent with the public interest, to wit: (A) the sale will make PUCI financially stronger; (B) the transfer of control will be transparent to PUCI's ratepayers in all aspects; (C) the absence of any immediate impact on PUCI's water rates, billing, or service quality; (D) if applicable, Applicants will not seek

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<sup>11</sup>Id. In its response to CA-IR-5, Applicants discuss a possible rate increase in 2007, "based on the fact that in the year 2007, it will have been 10 years since PUCI's last rate case decision and order." Applicants' response to CA-IR-5.

<sup>12</sup>Consumer Advocate's Statement of Position at 5.

to directly or indirectly recover any acquisition premium costs, goodwill impairment charges, amortization of goodwill, transaction or transition costs, or amortization of such costs through rates charged to PUCI's ratepayers.

The Consumer Advocate concludes that Buyer is fit, willing, and able to provide the water and wastewater utility services, and that the transfer of ownership is consistent with the public interest.

B.

HRS § 269-17

The Consumer Advocate recommends the commission's approval of Applicants' request to enter into the loan agreement between PUCI and Princeville, pursuant to HRS § 269-17, based on the following findings:

1. PUCI is in need of additional sources and storage to meet current and near term demand for water utility service. Seller is willing to sell the New Water Facilities at the purchase price of \$3,565,000, which equals the Seller's actual cost, reduced by the amount of CIAC paid for by the developers.

2. To finance this purchase, Princeville will loan PUCI up to \$4 million, with interest, amortized over ten (10) years. "The difference between the cost of the new water well and associated facilities and the total loan amount are expected

to be used to finance unforeseen capital expenditures and 'will not be drawn down unless those additional funds are needed.' "<sup>13</sup>

Accordingly, from the Consumer Advocate's perspective, "it appears that the funds from the loan proceeds will be used for the purposes set forth in HRS § 269-17." "<sup>14</sup>

C.

HRS § 269-19

The Consumer Advocate finds that: (1) PUCI's projected financial statements show that the repayment of the loan can be adequately covered with the inclusion of a rate increase in 2007; and (2) Buyer appears to possess sufficient financial resources to prevent a default on the loan. Accordingly, the Consumer Advocate does not object to Applicants' request for commission approval of a grant of a security interest in PUCI's income stream for the repayment of the loan to Princeville, pursuant to HRS § 269-19.

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<sup>13</sup>Id. at 8 (quoting in part Applicants' response to CA-IR-3a).

<sup>14</sup>Consumer Advocate's Statement of Position at 8. That said, the Consumer Advocate notes that: (1) based on the information contained in the present docket, it was unable to ascertain the reasonableness of the interest rate under the loan agreement; accordingly (2) it reserves this matter "for resolution in the next rate proceeding at which time PUCI should be required to provide documentation to support the interest rate that is reflected in the cost of capital calculation." Id.

VI.

Discussion

A.

HRS §§ 269-7(a), 269-7.5(b) and 269-17.5

HRS § 269-7(a) authorizes the commission to examine a public utility's financial transactions, its business relations with other persons, companies, or corporations, and other matters. HRS § 269-7.5(b), meanwhile, authorizes the issuance of a CPCN upon a finding that "the applicant is fit, willing, and able properly to perform the service proposed and to conform to the terms, conditions, and rules adopted by the commission, and that the proposed service is, or will be, required by the present or future public convenience and necessity[.]"

HRS § 269-17.5(c) provides in relevant part:

No more than twenty-five per cent of the issued and outstanding voting stock of a corporation organized under the laws of the State [of Hawaii] and who owns, controls, operates, or manages any plant or equipment, or any part thereof, as a public utility within the definition set forth in section 269-1 shall be held, whether directly or indirectly, by any single foreign corporation or any single nonresident alien, or held by any person, unless prior written approval is obtained from the public utilities commission[.]

Upon a review of the record, it appears that PUCI will continue to possess the technical expertise, and will be able to acquire the facilities needed to provide the utility services under the new ownership. Additionally, based on a review of PUCI's annual report and the financial information attached to the Joint Application and responses to the Consumer Advocate's information requests, it appears that Buyer will have fewer

liabilities and adequate financial resources at its disposal from its affiliate members HLDC and MSREF, as a result of the closing of the transaction. The commission agrees with the Consumer Advocate that Applicants' willingness to provide the utility services is evident by Buyer's willingness to: (A) utilize its financial resources to improve PUCI's financial condition; (B) loan PUCI up to \$4 million to purchase the New Water Facilities; and (C) have Princeville, the new developer of the Princeville resort community, coordinate its plans for developmental growth with PUCI in order to better prepare the utility's expansion plans.

The sale and transfer of PUCI's stock appears to be consistent with the public interest for the following reasons: (A) the sale will put PUCI in a better financial position; (B) the transfer of control will be transparent to PUCI's ratepayers in all aspects; (C) there will be no immediate impact on PUCI's water rates, billing, or service quality; and (D) if applicable, Applicants will not seek to directly or indirectly recover any acquisition premium costs, goodwill impairment charges, amortization of goodwill, transaction or transition costs, or amortization of such costs through rates charged to PUCI's ratepayers.

Upon review of the record, the commission finds that:

1. Buyer is fit, willing, and able to properly perform the requisite water and wastewater utility services.
2. Buyer is able to conform to the applicable terms, conditions, and rules adopted by the commission.

3. The water and wastewater utility services are, "or will be required by the present or future public convenience and necessity."

4. The transfer and sale of PUCI's stock to Buyer is reasonable and consistent with the public interest.

Based upon the above findings, the commission, thus, concludes that the transfer and sale of PUCI's stock, as set forth in the Sales Agreement, should be approved pursuant to HRS §§ 269-7(a) and 269-17.5(c).<sup>15</sup>

B.

HRS § 269-17

HRS § 269-17 provides that, upon the commission's prior approval, a public utility corporation may issue stocks and stock certificates, bonds, notes, and other evidences of indebtedness, payable at periods of more than twelve (12) months after the date thereof, for the following purposes, and no other:

for the acquisition of property or for the construction, completion, extension, or improvement of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the aforesaid purposes except maintenance of service, replacements, and substitutions not constituting capital expenditure in cases where the corporation has kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which the expenditures were made, and the sources of the funds in its treasury applied to the expenditures.

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<sup>15</sup>See also HRS § 269-7.5(b).

Conversely, "[a] public utility corporation may not issue securities to acquire property or to construct, complete, extend or improve or add to its facilities or service if the commission determines that the proposed purpose will have a material adverse effect on its public utility operations." HRS § 269-17. "All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void." Id.

Upon review of the record, the commission finds that: (1) the proposed loan under the loan agreement will be used to purchase the New Water Facilities and to finance, if necessary, planned and unforeseen utility capital projects; (2) the funds from the loan proceeds will be used for the purposes set forth in HRS § 269-17; and (3) such purposes will not have a material adverse effect on its PUCI's operations. Accordingly, the commission concludes that Applicants' proposal to enter into the loan agreement between PUCI and Princeville, pursuant to HRS § 269-17, should be approved.

C.

HRS § 269-19

HRS § 269-19 states that no public utility corporation shall assign, mortgage, or otherwise dispose of or encumber the whole or any part of its road, line, plant, system, or other property necessary or useful in the performance of its duties to



the public, "without first having secured from the public utilities commission an order authorizing it so to do." "Every such . . . assignment, mortgage, disposition, encumbrance . . . made other than in accordance with the order of the commission shall be void." HRS § 269-19. The purpose of HRS § 269-19 is to safeguard the public interest. *In re Honolulu Rapid Transit Co.*, 54 Haw. 402, 409, 507 P.2d 755, 759 (1973).

Upon review of the record, the commission finds that the granting of a security interest in PUCI's income stream for the repayment of the loan, in this instance, is consistent with the public interest under HRS § 269-19. The funds from the loan will be used to: (1) purchase the New Water Facilities that will be used and useful for the utility's daily operations; and (2) finance, if necessary, planned and unforeseen utility capital projects. Accordingly, the commission concludes that Applicant's proposal to grant a security interest in PUCI's income stream for the repayment of the loan to Princeville, pursuant to HRS § 269-19, should be approved.

## VII.

### Orders

#### THE COMMISSION ORDERS:

1. The transfer and sale of PUCI's stock from Princeville Corporation to Princeville PUC, LLC, as set forth in the Stock Sale Agreement, dated September 9, 2004, is approved, pursuant to HRS §§ 269-7(a) and 269-17.5(c).

2. The terms of the loan agreement to be executed between Princeville Associates, LLC and Princeville PUC, LLC, in an amount not to exceed \$4 million, to finance the acquisition of the New Water Facilities, is approved, pursuant to HRS § 269-17.

3. The granting of the security interest by way of a pledge in Princeville PUC, LLC's income stream in order to secure financing and credit facility arrangements, is approved, pursuant to HRS § 269-19.

DONE at Honolulu, Hawaii JAN 27 2005.

PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By Carlito P. Caliboso  
Carlito P. Caliboso, Chairman

By Wayne H. Kimura  
Wayne H. Kimura, Commissioner

By Janet E. Kawelo  
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Catherine P. Awakuni  
Catherine P. Awakuni  
Commission Counsel

04-0292.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21564 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: **JAN 27 2005**